

Oct. 6, 1999

LETTER 1288

BEAR MARKET: On August 4, 1999 the D-J Transportation Average broke below its June lows of 3316.11: in so doing, it rendered one-half of a Dow Theory bear signal. On September 23, 1999 the D-J Industrial Average confirmed the Transportation weakness by violating its own May low of 10466.93. The two Averages breaking below critical preceding lows have signaled that the **primary trend has turned down and that a primary bear market is now in force.**

Fortunately, the weakness was signaled far in advance, when, on July 29, my Primary Trend Index (PTI) dropped below its 89-day exponential moving average, thereby moving into its bear mode.

Phases: Each bull and each bear market is different. The final results, however, are the same. For instance, regardless of the pattern, stocks end up considerably higher before a bull market breathes its last. Conversely, although the progress may be volatile and confusing, stocks end up vastly lower before a bear market ends.

It is important to have an understanding of the phases. Bear markets develop in **three psychological phases** (not to be confused with price movements, although the phases are often separated by bear market rallies). The **first psychological phase** of a bear market sees stocks erase the excitement and froth of the preceding bull market top.

The **second psychological phase** (often the longest phase) sees stocks go down as they discount the bearish effects of declining business and squeezed profits.

The **third and final psychological phase** is the one where stocks head into the tank for no other reason than that investors need to raise money. This is the phase where those who have been saving for a rainy day find that -- it's raining. In the third phase, stocks will often sink below known values.

The end of the third phase is marked by severely depressed investors' sentiment, low volume on the exchanges, black business news, relatively high yields on top-grade stocks (yields of 6% and above are common) plus comments such as "this is the end of Wall Street as we know it" and "I never want to hear about stocks again" and "the Dow will be cut in half again within six months." (Those subscribers who were with me at the 1974 bottom well remember such expressions of bearishness.)

Support: Unlike corrections in a bull market, downside "support levels" in a bear market have little or no meaning. In fact, it is characteristic of a bear market to cut through supposed support levels almost as though they didn't exist. This is one of the surprising and frightening characteristics of bear market action.

Question: Russell, where do you think we are in this newly confirmed bear market?

Answer: So far, this is a rather unorthodox beginning for a bear market. I say that because despite the fact that the advance-decline ratio has been falling for 17 months, investor **sentiment remains highly bullish**, amazingly bullish, to my mind. In fact,

Sept. 23 DJIA 10318.59; PTI 5273; A-D Ratio -1.54
Oct. 1 DJIA 10723.00; PTI 5260; A-D Ratio -1.68
Dow Yield: 1.70%; Dow Price/Earnings: 24.0
Dow 144-day MA: 10273; Dow 34-day MA: 10813
Dow Times Book Value: 6.07; PTI 89-day exp. MA: 5321
Percentage of Undervalued Blue-chips: 9%
Gold 34-day MA: 266.4

in all the years that I've been observing markets, I've never seen such complacency and optimism in the face of many months of poor market action.

This persistent bullishness tells me that **we are still in the early part of the first phase of the bear market.** The froth is still here, as you can see by the persistent speculation in Internet and tech stocks. As we move further into the first phase, I expect to see this enthusiasm for net and tech stocks fade.

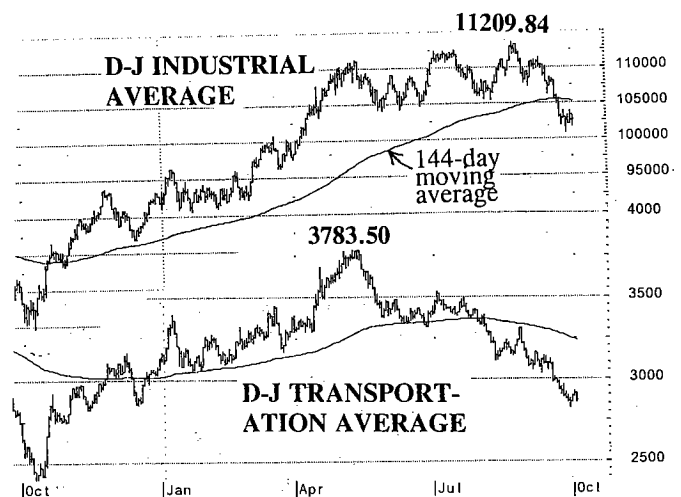
Remember, this sentiment doesn't necessarily have anything to do with the price action. After all, the Dow is now over 1,000 points below its August 25 high and investor sentiment is still extremely bullish.

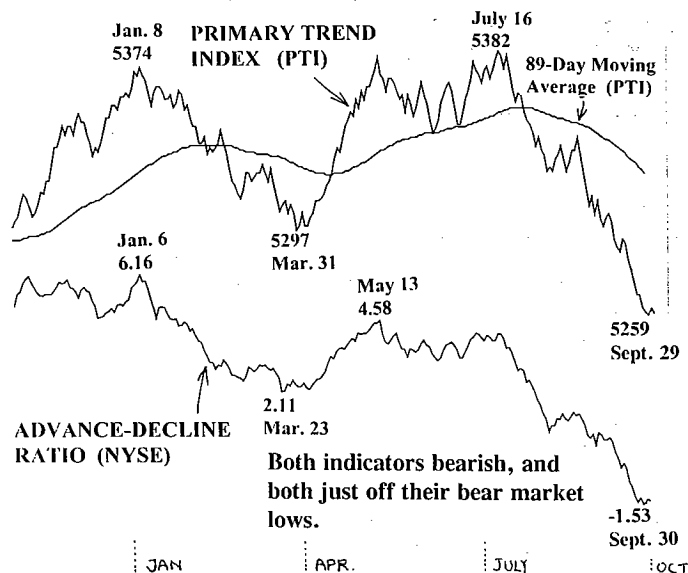
My guess is that the market will move erratically down until sentiment turns bearish or at least skeptical. At some point it will be conceded that a bear market is in progress, at which time we will probably see our first upward (often violent) counter-trend correction.

Note: The core of speculative or bullish sentiment is obviously centered in the Internet stocks and tech stocks. Therefore, it will pay us to watch these stocks carefully simply as a gauge of traders' sentiment in general. Before the first phase of the bear market has ended, I would expect to see a broad collapse in both sectors.

Question: Russell, business is good or even great, unemployment is at a 25-year low, corporate profits are excellent. In the face of this, how can we have a bear market?

Answer: Everything you're talking about is **history.** The stock market is not interested in history, it's only interested in conditions as they will exist tomorrow, next month and next year. The stock market, by its current action, is telling us that conditions are going to deteriorate; it's telling us that current





profit forecasts by the experts are wrong, it's telling us that the tide of optimism and great earnings is in the process of changing, it's telling us that the storm lies ahead.

Just as a rising stock market creates the much talked-about "wealth effect," a bear market in stocks will create what I call the "poverty effect." Debt will be squeezed, corporations that are too extended or badly financed will be pressed to the wall, individuals who are extended will be facing bankruptcy, and anything that can go wrong will go wrong. A bear market exists for the purpose of correcting the excesses of the preceding bull market. And the 1974-99 bull market created an enormous amount of excesses.

Question: What about the Fed? If things turn bad, won't the Fed come and flood the nation with money as well as lower interest rates? Can't the Fed stop a bear market in its tracks?

Answer: The Fed will certainly try. But the primary trend of the market is more powerful than the Fed, the Treasury and the Congress all taken together. Furthermore, if the Fed floods the market with even more money than at present and drops interest rates as well -- the dollar will cave in. And if the dollar starts to collapse, foreigners who now hold multi-billions of dollars worth of US securities will panic and dump those securities. All of which will just amount to more ammunition for the bear.

Question: Since you say this is a bear market, shouldn't I sell some stocks short or buy some puts here?

Answer: In general, I don't advise it. Speculating for profits in a bear market entails **expert timing**. Remember, when you go short you're not investing, you're speculating and trying to time the next decline. My experience with subscribers who short the market is that they usually get "taken" by a violent bear market rally. Furthermore, there are no long-term capital gains when you're short -- and finally, the short seller doesn't collect dividends, he pays them out as they are declared. So time is always against the short seller.

As for puts, they are generally too expensive except in times of market calm -- and in bear markets the market is seldom calm.

Remember this -- in a bear market **cash tends to buy more and more in the way of stocks**. So on that basis, cash (T-bills) represents an asset that is increasing in relative strength compared with stocks. And if we get real deflation (which I think we could), the T-bills will certainly look increasingly

attractive, simply because they are not going down while everything else is.

Question: I own stocks that I bought 15 years ago. I have huge capital gains, and if I sold my stocks I'd have to pay a slew of taxes. What should I do?

Answer: This is one of the toughest questions, and I can't offer the perfect answer. If you sit and it's a mild bear market, you're a genius. If you sit and it's a huge bear market, you're an idiot. Since neither I nor anyone else knows how severe this bear market will be, I operate on what I call "**correct procedure**." Correct procedure tells us that when the Dow Theory signals a bear market, we get OUT of stocks. Personally, I follow correct procedure and if nothing else, it allows me to sleep. I don't sleep more than five hours a night anyway, but I sure need those five hours. Furthermore, I keep my wife awake when I'm tossing and turning and then she gets really grumpy.

Robert Rhea, the great Dow Theorist of the '30s, told his followers that if you sit through a big bear market with all your stock positions intact, before it's over you won't have any tax problems. The bear market will take care of them for you.

Long Term: A few words about "holding for the long term." This is the phrase you hear everywhere, particularly from neophyte experts and university types who have never lived through a bear market or who are familiar with the market only as academicians.

Holding for the long term works beautifully in a bull market. In a major bear market it can be an absolutely disastrous policy. Remember, those who are sitting tight with their stocks for the long term have absolutely NO EFFECT on the market. Only those who are actively buying and selling stocks have an effect. If panic overtakes the market -- the sellers will determine the price, since they will sell down to their "comfort zone." During 1929-32 for instance, the sellers took the Dow down 89% from its high. We'll probably never see anything like that again, but in the bear market of the early 1970s we saw the Dow lose half of its value. Remember, "the market can do anything," and this is a market that has not had a full correction in a quarter of a century.

If this turns out to be a MAJOR bear market, the phrase "hold for the long term" will be the most hated phrase in the nation.

Question: OK, Russell, you say we're in a bear market. What are you looking for next?

Answer: Well, first I want to see whether the Dow will break below 10,000. I think the Dow breaking below 10,000 would have a very negative psychological effect on stockholders.

If the Dow breaks below 10,000 I would then watch to see whether the Dow has done something that it hasn't done in 25-years or since 1982, and that's to break below the low of a preceding year. The Dow closing low for 1998 was 7539.07. If the Dow breaks below that figure, I would say that the bear market was beginning to move into "high gear."

Question: Would you say something about the news and how it may affect a bear market?

Answer: In a bull market, bad news is "appreciated," since, ironically and counter-intuitively, bad news helps to build the proverbial wall of worry on which a bull market climbs. But in a bear market, bad news drives stocks lower, since bad news is in harmony with the basic bear trend. In other words, in a bear market, bad news should be taken for just what it is -- bad news.

One of the fascinating phenomena of the current market picture is the almost total concentration on the news of the day as an explanation for the movement of the day. For instance, if the

market declines on a given day the experts will tell us that "it's the negative trade balance that pressured the market down" or "it's the weak dollar that drove the market down" or "it's a rumor that Greenspan is thinking of raising rates a notch."

But bear market weakness is not a one-day or a one-week affair - it's a **continuing trend**. The fact is that the weakness has been going on for 17 months, ever since the advance-decline ratio topped out on April 3, 1998. Furthermore, the huge head-and-shoulders tops in both the NYSE Composite and the S&P 500 have been over six months in the making. Meaning that money, big money, has been distributing stocks for many, many months. The smart money has been moving "out," even while the public continues to move "in." And obviously, the funds, which are almost by definition 95% invested, are surely still very deeply "in."

Question: Russell, you mentioned that we should "take out insurance" in this bear market. What kind of insurance are you talking about?

Answer: In a bear market, the best insurance is the best currency or in some instances, the ultimate money, which is (would you believe?) gold. But the next best insurance is a strong currency. For average Americans, since they are not used to trading currencies, the best place to be is in Treasury bills. And there's nothing wrong with owning some gold coins or some shares of Newmont Gold or Barrick.

Question: I know that the breadth has been going down since April of last year. How does this translate into actual price action for most stocks?

Answer: This is at least one answer: According to a tabulation by Donaldson, Lufkin & Jenrette, more than 3700 NYSE stocks are now showing an average decline (unweighted for capitalization) of 24% from their 52-week highs (which is why I've been calling this the "stealth bear market").

Question: How far down do you think the bear market could carry on the downside before it is over?

Answer: The talk among even those who are "bearishly" inclined, is that we are possibly in for "a correction of 10% to 15%." The fact is that these "bears" don't have any idea of where this market is heading. I listen to CNBC all day long, and I've yet to hear anyone talking about a full-fledged primary bear market. Now obviously I don't know what lies ahead, but I do know that this is a bear market, and in a bear market stocks head down. How FAR down this market goes nobody knows. We don't know because a principle of the Dow Theory tells us, "Neither the duration nor the extent of a primary movement can be predicted in advance."

However, I do know this -- historically, the greater the bull market, as a rule, the greater the bear market that inevitably follows. The bull market of 1974 to 1999 was by any account the greatest bull market in history. Is it therefore unreasonable to suggest that we could be heading into one of the greatest bear markets in history? I'm not saying that that's what definitely lies ahead -- but to say that we're only facing a 10% or 15% correction is the height of arrogance or else the height of ignorance.

Question: Russell, I'd always heard that bull markets end with some kind of an upside blow-off. Where was the blow-off?

Answer: It's been in the tech stocks and in its core -- the Nasdaq 100 and the net stocks. In fact, in all the years that I've been watching the market, I've never seen anything like the wild speculating in tech stocks and the IPOs of the dozens of new Internet stocks that have hit the market over the last year.

FURTHER COMMENTS: One of the reasons I have not liked this market is what I term the "top-out parade." This parade is a phenomenon that I really haven't seen anyone comment about. The fact is that one by one the various market averages and indicators have been dying. I listed them in the last Letter, but just to re-emphasize the point, I want to list them again. Here they are.

The daily new highs topped at 631 on October 3, 1997.

The advance-decline ratio (NYSE) topped out on April 3, 1998.

The Russell 2000 (small stocks) topped out at 491.41 on April 21, 1998.

The D-J Transports topped out on May 12, 1999 at 3783.50.

The NYSE Financial Average (all financial stocks, banks, S&Ls, small loans, etc.) topped out on May 13, 1999 at 584.22.

The D-J Utility Average topped out on June 16, 1999 at 333.45.

The S&P 500 topped out on July 16, 1999 at 1418.78.

The NYSE Composite topped out on July 16, 1999 at 663.12.

The Dow topped out on August 25, 1999 at 11326.04.

The Nasdaq Composite topped out on Sept. 10 1999 at 2887.06.

There are a few items that we have to watch carefully now. The first and foremost is the Nasdaq 100. It's been the core of strength in this market. As a rule, when the last bastion of strength in the market turns weak, that's it, the air is finally rushing out of the balloon. The Nasdaq 100 hit a high of 2545.41 as recently as September 20.

The **Nasdaq 100** is still in a well-defined bull trend. The first hint of trouble would come if the Nasdaq 100 closes at 2310 or below.

A second area that I am watching closely is **IIX, the Internet Index**. IIX hit a high of 358.32 on April 26. From there IIX sank to a low of 253.41 on August 9. From there IIX rallied to 326, matching the July peak. The Internet sector continues to be a glamour sector, an area of big rallies and big declines. Important renewed weakness would come if IIX closes below 300. I continue to watch the Internets, a center of generally wild speculation.

A third area that is extremely important is the **NYSE Financial Index**. This Index includes ALL financial stocks, banks, S&Ls, small loans, brokers. In my opinion, this Index has topped out. And this is very bearish for the market.

A fourth area is very significant and watched by very few. It can be seen in the **Morgan Stanley Consumer Index**. This index, since January, has been tracing out a dangerous "rounding top." On September 22, the top was completed and the index plunged. What is this telling us? As I see it, the top-out of the Consumer Index is telling us that somewhere ahead (probably within 2-4 months), US consumers are going to be pulling back on their buying -- and next they will turn to actual savings. Consumer buying accounts for two-thirds of the Gross Domestic Product. You do the math.

Charts of all four items appear on page 4.

I wanted to include the page 4 charts in this Letter, which forces a slightly different format, and it looks as though I will also include less of the Notes & Quotes section in this mailing. Ah well, variety is the spice . . .

INVESTMENT POSITION: It shouldn't come as any surprise to subscribers that the bull has died and the bear has taken over the box. What does this mean for my subscribers? That's easy, it means that we're in a bear market of indeterminate duration and extent and that the best procedure is to follow the time-honored position dictated by the Dow Theory. Here it is -- in a newly signaled bull market, get 100% invested in quality stocks. In a newly signaled bear market, get OUT of stocks and get in T-bills or T-notes or the highest-rated muni bonds -- and await developments. As a rule, awaiting developments means that those who are "holding stocks for the long term" will sustain tragic losses. For those holding T-bills, awaiting developments means watching stocks decline while their assets remain generally stable.

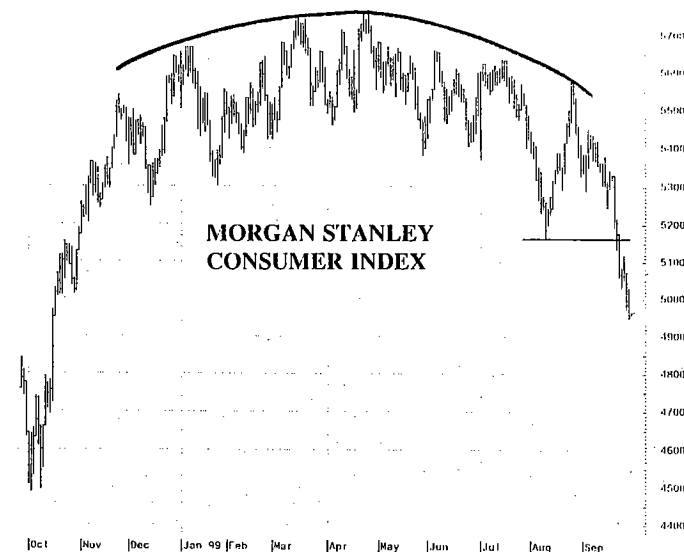
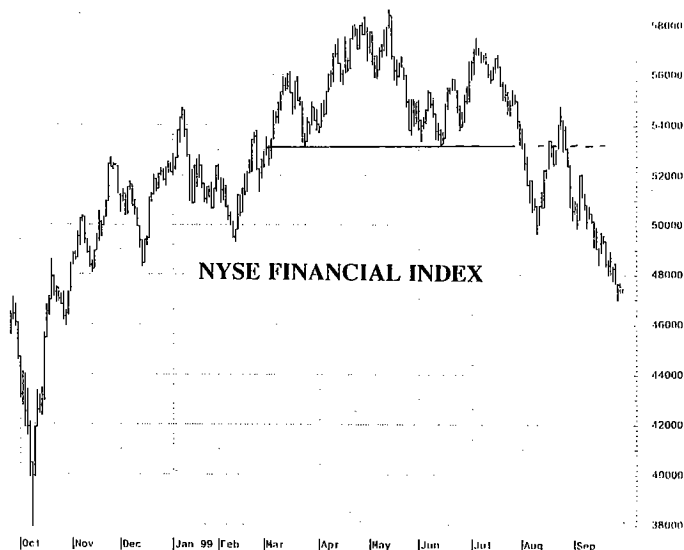
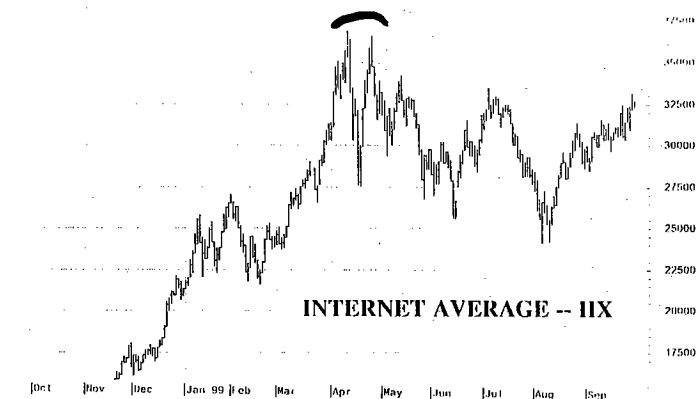
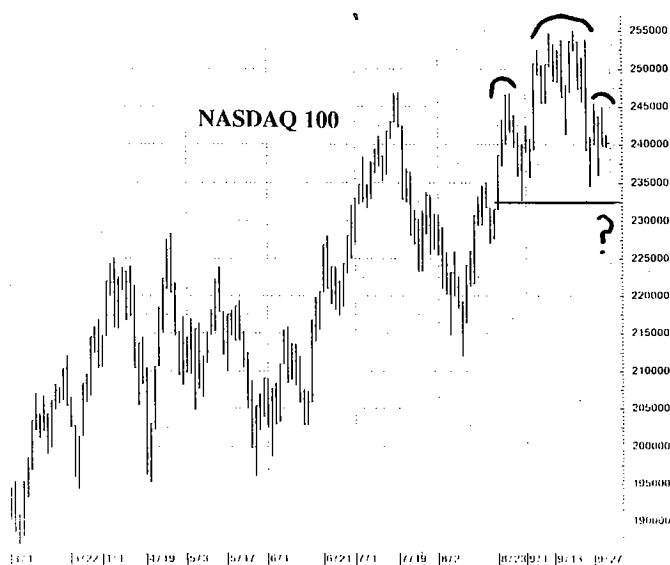


The stock market has a habit of doing what the majority least expects. If the market is going to run true to form, it will produce a full-fledged bear market with the major averages going far below what the majority is expecting.

As an example, in April of 1971, the advance-decline ratio was 6.85. By December, 1974 the A-D ratio had dropped to minus 36.50, a total loss of **43.35 points**. To date during 1998-99, we have seen the A-D ratio drop from 13.00 in April of 1998 to minus 1.80 last week, a loss of **14.80 points**.

On April 12, 1972 my PTI stood at 1072. By December 27, 1974, the PTI had dropped to 125, a loss of **947 points**. In comparison, this year my PTI hit a record high of 5382 on July 16, 1999. The recent PTI low figure of Sept. 28 was 5261, meaning a loss so far of **121 points**.

Obviously, I'm not saying we're moving into a 1972-74 situation, but the comparisons show what could happen. Thus, it is only prudent to take out insurance, which means **OUT of stocks**.



NOTES & QUOTES: The action in the world's markets really amounts to a massive flow of funds. Right now the flow is moving out of the US and to Asia, Japan and Europe. The outrageously negative US trade balance has demonstrated this for many months. The US has been leading the good life, on a buying binge, taking in the products of the world, and paying with those products with paper, better known as dollars. And it's a question of how long the world will be willing to swap their products for paper, and for how much paper? When the world

has had its fill, the dollar will head down, which it could now be in the process of doing.

As the dollar sinks, our overseas friends who own billions of dollars of US securities get nervous -- and the lower the dollar sinks, the more nervous they get. Ultimately, if the flood of dollars going overseas continues (and dollars are flowing overseas at the rate of \$1 billion a week), our overseas friends will start to dump their US-based securities. That will be a nasty turn of events. But every party must eventually end, and the US has been partying for a mighty long time.

US Trust, over the past eight years, has studied people in the 99th percentile of taxpayers, people who earn (according to the IRS) an average of \$227,546 a year. Most were well fixed, in that 31% were worth \$1 to \$3 million, 31% were worth \$3 to \$5 million and 20% were worth over \$5 million. But this is what was so interesting in the study. They pay an average of 42% of their income in federal, state and local taxes. But they SAVE 27%. So between taxes and savings, that's 69%. The rest goes for living expenses. What struck me was the 27% that they saved. This compares with the negative savings rate for the nation today. **Russell Comment:** If you want to be rich or at least close to rich -- save and compound your savings. You don't have to pick great stocks. Just buy safe dividend-paying stocks or good bonds or notes and compound, compound, compound.

If you're not fascinated with the Internet, you're missing the new revolution. On September 22, the *NY Times* published a special section on the net. One piece was particularly interesting and informative, and I include a few paragraphs from that piece here.

FOR established firms, it's hard to compete in the new economy when you are saddled with old-economy handicaps like investors who expect you to make a profit. That's why more and more companies are considering following the lead of Barnes & Noble, which took its Web site public so that it could be its own money-losing Internet company.

It did this only after Amazon.com, by far the most successful on-line merchant, garnered more than 10 million customers. Indeed, Amazon's sales this year are expected to exceed \$1.5 billion, which amounts to about half the total sales that Barnes & Noble rings up from its 1,000 stores. Now Amazon has expanded into music, toys, electronics and auctions and will soon add other categories. It can afford to do this because investors snapped up \$1.25 billion of high-yield Amazon bonds earlier this year, even though the company does not expect to make a profit in the foreseeable future.

For the same reason Amazon is feared in corporate America, it is being repeatedly emulated by the nation's entrepreneurs, who are trying to start the Amazon.com of this or that. Those business plans that win the blessing of Palo Alto's venture capitalists will be run down an assembly line that can turn an idea into a company almost as quickly as Henry Ford's River Rouge plant turned iron ore into cars.

Typical is the story of Jessica DiLullo and Jenny Lefcourt, who in the fall of 1997 were first-year students at the Stanford Business School. Like most of their classmates, they talked of little else but what Internet company they could start. They decided to be the Amazon.com of wedding registries and spent the school year researching a business plan for a site they named Della & James, after the characters in the O. Henry story "The Gift of the Magi."

By May, they had sold the idea to Kleiner Perkins Caufield and Byers, the influential venture capital firm that had backed Amazon. In just a few months, they had raised \$5 million, hired an experienced chief executive and forged links to established retailers including Williams-Sonoma and Neiman Marcus. As everywhere, competitors abound, from newcomers like Theweddingchannel.com to established players like Macys.com.

"Every category is being inundated," said Anthony Noto, an electronic commerce analyst with Goldman, Sachs. "No one wants to miss the boat."

LOOK behind all this technical wizardry, however, and you'll see a lot of businesses that are staying together on little more than packing tape and a prayer. After all, it's much easier to make a pretty Web site, and advertise it on America Online, than to make sure you have the goods the site is offering in stock.

The latest issue of the London *Economist* (Sept. 7) carries the cover story, "Trapped by the Bubble." The magazine then blames a timid Alan Greenspan for allowing the market to continue to climb to bubble status, this despite the fact that Greenspan warned back in December, 1996 about "irrational exuberance." But, ironically, instead of raising margins on stocks or raising rates, Greenspan pushed interest rates down (ostensibly to save the rest of the world), and now he has the problem of a sky-high market bubble, a bubble that presents a potential danger to the nation and the world. Does Greenspan believe that the market is in a bubble mode? I think he does. But he doesn't want to be the pin that pricks the balloon. **Russell Comment:** It's OK, Alan, as usual the market will be doing your work for you; the air has been leaking out of the market balloon ever since April 3, 1998, the date when the advance-decline ratio topped out. As for the potential big bubble pop, that lies ahead.

Ned Davis in his latest report shows two charts. The first shows stocks as a percentage of total household assets. The second chart shows stocks as a percentage of total institutional assets. Writes Ned Davis, *"If one believes, as I do, that almost by definition the top is the point of maximum optimism, then it follows that with the public and institutions never more optimistic, the rise of a top has never been as great."*

Warren Beatty talking about running for President of the United States. Donald Trump threatening to run. John McCain throwing his hat in the ring. What's going on? I think that Americans are sick and tired of professional politicians and their mealy-mouthed statements and their money-raising shenanigans. Americans are tired of the Clintons and all their slimy scandals, they're suspicious of Al Gore and his long history of politics and his close connection with the Clintons, and many Americans are dismayed by Hillary probably running for Senate. ("Will we ever be rid of the Clintons?")

Jesse Ventura set the trend. Here's a pro wrestler with brains, an amateur who shocked the nation by actually getting elected governor of Minnesota. And, further shock, Jesse's doing a good job. And he's a refreshing, non-political type speaker. He's the modern version of New York's much-loved Mayor Fiorello LaGuardia, the "Little Flower." An independent non-political type, LaGuardia was asked how he could possibly beat the regular politicians. Said LaGuardia, "I could beat those political bums on a laundry ticket." And he did. I do believe that's the kind of spirit that is running through much of America today.

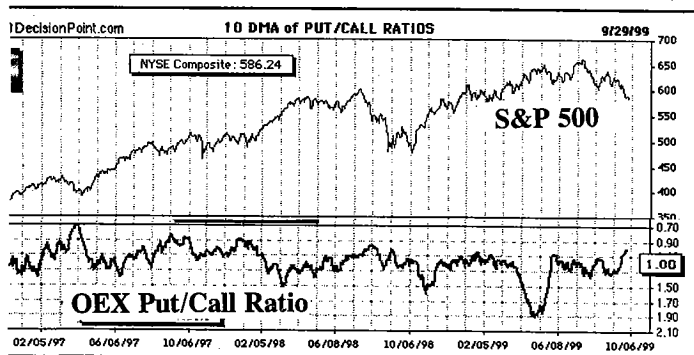
Poor old Al Gore. Back in 1993, Gore was the point man for the generous US policy towards sending billions of dollars to Russia. In fact, in '93 Gore complained that the IMF and the world bank were "slow to recognize some of the hardships that are caused by some of the conditions that have been overly insisted upon in the past." Gore elaborated when he pointed to "the enormity of the opportunity for the world to integrate this magnificent nation into the common effort of humankind to build a better way of life for the peoples of the world." Ah, time passes, and today it turns out that most of the money given to Russia has disappeared down a cess pool of corruption, corruption on a scale literally unmatched in global history. Now it turns out that billions of dollars were transferred out of Russia and into private hands including foreign and US banks. Said Majority leader Dick Armey (R, Texas), "Clinton-Gore policy was to help Russia become a peaceful and productive free-market democracy. Instead, Russia has become a

looted and bankrupt zone of nuclearized anarchy." Gore is now downplaying his role in the Russian disaster. Between the Russian mess and his Clinton "baggage," Gore's light is dimming while Bradley's is becoming brighter.

A Russell Prediction. We're moving into the century of the women. Why do I say that? First, in the US, the number of men receiving bachelor's degrees from college has been relatively stable for the last 25 years. But the ratio has changed. American women now receive 55% of masters degrees and about four out of 10 of first professional degrees and Ph.Ds. Their share of all three types of degrees is rising. The same thing is happening in most of the English speaking nations of the world. On top of this, with the Internet expanding, women around the world are beginning to see the picture. They've been held down for centuries, but increasingly they're going to want their rights. The era of male dominance will end. The growing educational disparity is already affecting the social system in the US. The problem -- starting with the year 1998 women with an advanced degree outnumbered men; this suggests that highly educated women are going to have a harder time finding a suitable mate. Fact: Currently more than 11% of corporate officers in Fortune 500 companies are women. Watch this figure -- it's guaranteed to go higher. Sign of the times: My wife, Faye, is now managing partner in the San Diego office (50 lawyers) of an international law firm of over 500 lawyers with 10 offices throughout the nation and overseas. This never could have happened 15 years ago.

If Cisco isn't a mainstay in the Internet business, it isn't for lack of trying. Last week they bought WebLine Communications for \$325 million (in stock, naturally, not for cash). The acquisition is Cisco's 12th this year. Over the last six years, Cisco has bought 42 companies. Cisco's policy is that they'll buy any technology that they can't or don't want to develop themselves.

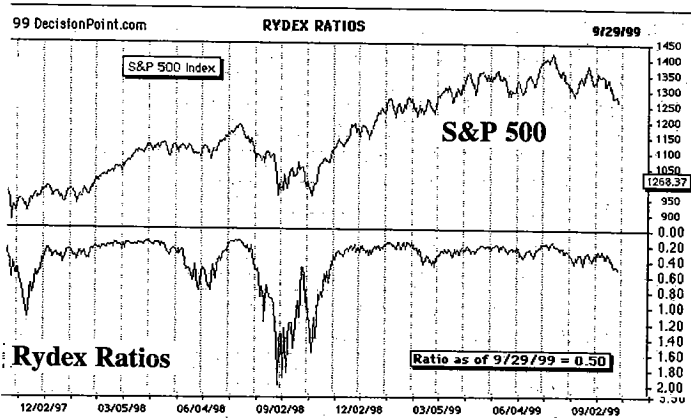
Amazing complacency: These two charts are from the fine net site, www.decisionpoint.com. The first chart shows the OEX put/call ratio. What we see here is that speculators are actually stepping up their purchases of calls -- in other words, betting that the market will move higher, thus putting their calls in the money. Most option buyers (maybe as high as 85%) tend to lose money in their options trading. This is interesting in view of the fact that the action has been in the direction of heavy call buying rather than put buying.



The second chart shows an even more extraordinary picture. Rydex tracks the amount of money going into both its bull fund and its bear fund. Then they construct a ratio. If the ratio is rising, it means that more money is pouring into their bull fund rather than their bear fund. The converse is true when the ratio is heading down.

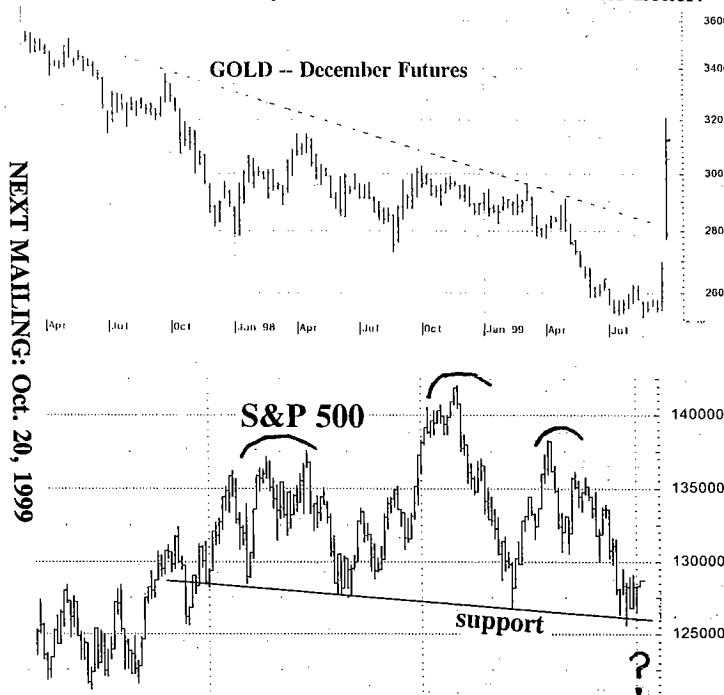
Note that in late-1998, when the market was sliding, the Rydex ratio plunged, meaning that people were buying the bear fund heavily, rather than the bull fund. Today, with the market acting poorly, the ratio has hardly budged down. Investors are evidently convinced that this is no time to buy the Rydex bear

fund. Thus, the extraordinary complacency continues, despite the almost uninterrupted breadth collapse and the losses in the majority of stocks.



GOLD: I'm showing weekly Dec. gold to provide a better perspective on what's happening. Here we see a huge upside gap in the weekly chart, and an attack on the mid-April peak of 314. It will be important for gold's upside progress to move above the 314 level, but it may take some consolidation first. On the other hand, if gold refused to better the 314 level, it may mean that gold simply adjusted closer to true value, which, in my opinion, should be considerably higher. In talking about gold, I'm skipping all the usual fundamental arguments (and I'm being bombarded with them) and going strictly by the price action. I continue to suggest holdings of Newmont and Barrick.

Question: Russell, what if you're right about the bear market, and what if you're right about a coming worldwide deflation? How will that affect gold? Answer: **Honest,** I'm not sure; I can make a case either way, and I'll talk about that in a later Letter.



S&P (cash): You can see that this widely-watched Index has traced out a huge head & shoulders top pattern, and it's been fluctuating just above critical support for the last seven days. The S&P is like the depressed lady standing on the bridge overlooking the icy water -- and she's debating. "Will she or won't she?" We should know soon. I'd say that S&P would have to close at 1250 to indicate that the whole structure was breaking down, in which case, "Look out below."